UNITED NATIONS **DP**

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.
GENERAL

DP/FPA/1997/10(Part IV)
5 March 1997

ORIGINAL: English

Annual session
12 - 23 May 1997, New York
Item 8 of the provisional agenda
UNFPA

UNITED NATIONS POPULATION FUND

REPORT OF THE EXECUTIVE DIRECTOR FOR 1996: UNFPA INTERNAL AUDIT AND OVERSIGHT ACTIVITIES IN 1996

1. This report provides the Executive Board with a summary of internal audit and oversight activities of the United Nations Population Fund. The report is being submitted pursuant to a request made by the Executive Board at the second regular session 1996.

I. ORGANIZATION AND RESOURCES

2. Under the provisions of UNFPA Financial Rule 114.18, the Executive Director has arranged with the Administrator, UNDP, for the internal audit services of the Fund to be undertaken by the UNDP Division for Audit and Management Review (DAMR). The Executive Board may also want to refer to the Report of the Administrator of UNDP on internal audit and oversight activities (document DP/1997/16/Add.6).

3. Based on Governing Council decision 91/36, UNFPA was authorized to strengthen the capacity of DAMR to support internal audit functions of UNFPA by creating a UNFPA Internal Audit Section. This was considered a first step towards the establishment of UNFPA's own internal audit capability. The section became operational in May 1993 and consists of a chief, one management auditor and one support staff. With current resources, it is not possible for the section to provide audit coverage for all UNFPA units within the optimal cycle of five to seven years, and

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efforts have been made to expand activities through, *inter alia*, the use of consultants. The matter will also be addressed in the UNFPA budget proposal for the 1998-1999 biennium.

4. Given the resource constraints, UNFPA has sought to increase audit capacity through agreements with UNDP for the use of the UNDP Regional Service Centres in Kuala Lumpur and Harare. Based on these agreements, each centre contracts a public accounting firm to examine the annual accounts and compliance audits of all those UNFPA offices that have a UNFPA-appointed Representative in the Asia and Pacific and the Africa regions, respectively. The agreement with the centre in Kuala Lumpur was initiated in 1993, followed by Harare in 1994. The agreements are supervised by DAMR. Any reports prepared under this agreement are reviewed by the UNFPA Internal Audit Section and are issued in accordance with the regular audit reporting procedures of DAMR.

5. In addition to the activities of the UNFPA Internal Audit Section/DAMR, internal oversight services are also provided by the Fund's Office of Oversight and Evaluation, which was established in late 1996 and reports directly to the Executive Director. Some of the functions of this office were previously discharged by the Evaluation Branch, Technical and Evaluation Division. In addition to programme and thematic evaluations, the office now also undertakes policy application reviews to examine in depth the processes of programme development and implementation and to assess, *inter alia*, where greater clarity in programme policy and technical guidance is needed to ensure substantive accountability under decentralization. Such reviews were conducted in seven countries during 1996. Further information about the findings of the policy application reviews and other evaluation activities are contained in the Report of the Executive Director for 1996: Evaluation Activities (document DP/FPA/1997/10 (Part III)), which is also being submitted to the current session of the Executive Board.

6. The emphasis given to sound internal oversight by the Executive Director is also reflected in the mechanisms established for the review, monitoring and follow-up of the findings and recommendations of such exercises. Primary responsibility now rests with the Office of Oversight and Evaluation, which is tasked with ensuring that the necessary corrective action is taken in response to any oversight activity. Previously, these tasks had been divided between the Director, Technical and Evaluation Division for policy application reviews and evaluation reports and the Deputy Executive Director (Policy and Administration) who continues to serve as focal point for internal and external audit matters. Within its overall coordinating role, the Office of Oversight and Evaluation works with the Deputy Executive Director (Policy and Administration) on the follow-up to audit activities, reports to the Executive Director on trends in audit reports and develops proposals for dealing with non-compliance by staff with the recommendations of oversight functions. In addition, audit and oversight issues continue to be discussed regularly by the UNFPA Executive Committee, which is composed of the senior management of UNFPA.

II. INTERNAL AUDIT ACTIVITIES IN 1996

7. The principal internal audit activities carried out in 1996 included the following: (a) eight management audits in six country offices and two Country Support Team (CST) offices; (b) 45 compliance audits in 13 country offices in the Asia and the Pacific region and 32 country offices in the Africa region, undertaken by two international public accounting firms; (c) a comprehensive review of audit clause requirements for Government- and NGO-executed projects; (d) a review of government-in-kind contributions; and (e) six audit communications addressing weaknesses in UNFPA's financial regulations and rules. This work plan compares to a total of five audit activities undertaken by DAMR for UNFPA in 1992, prior to the establishment of the section.

8. The Executive Director is highly satisfied with the services provided by the UNFPA Internal Audit Section/DAMR, which has successfully implemented a broad work plan in 1996 despite limited resources. The management audits, conducted by the section, have proven invaluable to the strengthening of the performance of UNFPA, not only through the actual audit exercises but also through the ongoing dialogue between UNFPA top management and the section on fundamental policy and procedural aspects of UNFPA operations. Such dialogue has been characterized by a spirit of close cooperation and has confirmed the importance of internal audit as a vital management tool.

9. The annual audit work plan is developed by the section in close consultation with the UNFPA Deputy Executive Director (Policy and Administration), the UNFPA Office of Evaluation and Oversight, and the external audit team of the United Nations Board of Auditors. Synergies between the various oversight activities are explored and schedules coordinated to the greatest extent possible. The work plan is reviewed periodically throughout the year in order to adjust the timing and scope of audit activities, as required. All audit exercises are preceded and followed by extensive consultations with the organizational units concerned.

III. PRINCIPAL AUDIT FINDINGS AND ACTIONS TAKEN

10. According to the ratings issued for compliance audits by the contractors in the Asia and Pacific and the Africa regions, the level of internal controls in the vast majority of UNFPA offices was considered satisfactory. Of 53 audit reports issued in 1996 (covering both 1995 and early 1996 audits), the level of internal control and the compliance with financial and administrative requirements of office management was found to be satisfactory in all offices, with three offices receiving a "good" rating. In programme management, four offices were found to be "marginally deficient" and one office "deficient" (the latter rating was, however, not considered justified by the Director, DAMR).

All of the remaining 49 reports found programme management to be satisfactory. While the Executive Director is pleased about the generally satisfactory level of compliance, the following issues require attention:

11. Clarification of procedures. Management audits continue to find two main causes of difficulties in the application of procedures. For one, a number of UNDP procedures are *mutatis mutandis* applicable to UNFPA in the absence of specific UNFPA procedures. In issuing guidelines, headquarters has, however, neglected to highlight the linkages and include cross-references to UNDP manuals. Secondly, since UNFPA has often issued guidelines in the form of circulars and memoranda, there is need to have available a consolidated set of policies and procedures. This problem has also been raised by the United Nations Board of Auditors.

12. The Executive Director has taken action on this matter in establishing a task force on policies and procedures in October 1996 with a one-year mandate to compile and issue a consolidated set of five binders, including the completion of the three-volume Policies and Procedures Manual. During this exercise, UNFPA consults closely with the auditors and with its UNDP counterparts in identifying requirements for new guidelines, streamlining of procedures and enhancing consistency. The process will be completed in late 1997 and will replace all previous, separately-issued guidelines.

13. Legal basis of project activities. As has been pointed out by the United Nations Board of Auditors, the legal substratum of UNFPA-funded activities is not always properly secured by country office staff: this was the cause of the "marginally deficient" rating in the programme management of four offices. Deficiencies or problems include, for example, the initiation of project activities before signature of the project document and letter of understanding by all parties. Some of the difficulties arise from the nature of the UNFPA programming process, which, in contrast to UNDP and UNICEF utilizes multiple executing agencies. Consequently, the process of signing the required documents is more time-consuming and tends to delay implementation.

14. The Executive Director has repeatedly reminded country offices that despite possible delays, project activities may not commence without the properly-signed legal instruments. Compliance has improved under the Fund's decentralization policy, initiated in December 1993, because of reductions in the time required from project formulation to signing of the project document. In addition, the move towards the use of sub-programmes, rather than projects, within country programmes will help reduce the administrative burden on Governments in the review and signing of legal documents and should facilitate timely implementation. At the same time, UNFPA will continue to stress to all staff that the legal basis for the disbursement of UNFPA funds may not be compromised under any circumstances.

15. Management of project audits. In 1996, the UNFPA Internal Audit Section/DAMR also undertook a comprehensive review of the audit clause requirements for Government- and NGO-

executed projects. The review was to identify the reasons for instances of late submission of project audit reports, which have, in turn, resulted in the qualification of the audit opinion of UNFPA's financial statements by the United Nations Board of Auditors. The review argued for several revisions in UNFPA guidelines in order to strengthen the management of the project audit clause, including the designation of the audit authority in the letter of understanding, provision of terms of reference for project audits, correct formulation of certain certification requirements, and clarification of the time-frame stipulated for the submission of project audit reports. The review also considered it crucial that UNFPA procedures distinguish properly between internal and external audit functions and assign responsibilities accordingly.

16. In following up the findings of the review, UNFPA has drafted revised financial rules in close consultation with the Internal Audit Section/DAMR and will institute a monitoring system to ensure compliance with the audit clause and effective follow-up to the findings of the executing agency's auditors. Once completed, the results of this exercise should help address the concerns about project audits expressed by the United Nations Board of Auditors, the Fifth Committee and the Executive Board.

17. Revision of financial regulations and rules. Closely related to the review of the audit clause requirements was the issuance of several audit communications addressing weaknesses in UNFPA's financial regulations and rules. Within the framework of the Task Force on Policies and Procedures, UNFPA has started addressing the findings of these communications by, *inter alia*, developing clearer definitions of executing, implementing and associated agencies in the programming process and by clarifying substantive and custodial accountability issues, among others.

18. Actions to be taken. The Executive Director is confident that the policy initiatives outlined above will greatly facilitate programme management at the country level. In addition, individual findings and recommendations are followed up with the concerned offices or units. However, although the section has accomplished a remarkable work plan with very limited resources, UNFPA management and the auditors agree that management audits of headquarters require more attention. Thus, in 1997, two organizational units at headquarters have been selected for internal audits in place of two country offices.

19. Another remaining concern of UNFPA is that despite interventions from DAMR, the performance of the public accounting firms contracted by the UNDP Regional Service Centres in Kuala Lumpur and Harare continues to be uneven. While UNFPA fully supports the out-sourcing of compliance audits under commercial contracts, the Regional Service Centres lack professional auditors dedicated to UNFPA to provide supervision of the work of the contractors. As a result, 21 audit reports for 1995 had to be returned by the UNFPA Internal Audit Section/DAMR for revision. Additional training was provided in 1996, coupled with the preparation of detailed audit guidelines

and reporting formats for compliance audits of UNFPA offices in order to achieve a more even performance under these contracts.

20. Given the resources and staff time required for the processing and follow-up of the 45 compliance audit reports produced annually, UNFPA would like to caution against an over-emphasis on the quantity of audit activities. While this approach was useful in establishing basic track records for each office through 2-3 consecutive audit visits, it may now be advisable to concentrate resources on fewer, specified activities when contractors are used. UNFPA has been in discussions with DAMR to review various options and decide on the most cost-effective and thorough audit arrangements for 1998-1999.

IV. RECOMMENDATIONS

21. The Executive Board may wish to:

(a) take note of the report on internal audit and oversight activities; and

(b) express support for the strengthening of the internal audit capacity of UNFPA.